

CHAPTER 20

SIMPLIFY PENALTIES

General Explanation

Chapter 20.01

Current Law

The Internal Revenue Code contains a wide array of civil penalties for violation of its reporting and payment provisions. These penalties, set forth in over 75 different provisions, are intended to impress upon taxpayers the significance of their Federal tax obligations, to provide meaningful incentives for compliance and to compensate the United States for the expense of investigation and collection.

Penalties are imposed in addition to interest on deficiencies.

The penalty under current law for failure to pay taxes when due is .5 percent of the amount of the overdue tax per month, up to a maximum of 25 percent.

Reasons for Change

The penalty provisions under existing law are overly complex and often result in inconsistent treatment of similar violations. Penalties have been added piecemeal to the Code as new filing and reporting requirements have been legislated. The inconsistencies in the present penalty structure undermine horizontal equity among taxpayers and make the penalty provisions difficult to understand and administer.

The existing penalty for failure to pay taxes when due is overly burdensome, and generally falls on taxpayers whose failure to pay is not willful.

Proposal

The penalties relating to failure to file information returns, failure to furnish information, failure to provide information on a return, and filing false information would be consolidated into one provision with uniform penalties as follows:

- (a) failure to file information tax return: \$1,000 or 10 percent of gross proceeds required to be reported on the return, whichever is less;

- (b) failure to file information statement: \$50 for each statement;
- (c) failure to furnish or provide data: \$50 for each transaction;
- (d) failure to supply information on return, statement, or document: \$10 for each failure;
- (e) filing incorrect information on a return or statement: \$50 for each false statement;
- (f) if any failure described in (a), (b), (c), or (d) above is due to intentional disregard of the filing requirement, then the penalty shall be 10 percent of the gross proceeds or other amount required to be reported on the return or statement with no maximum limitation, or \$500, whichever is greater. If the filing of incorrect information in (e) above is intentional or due to reckless disregard of the truth, then the penalty shall be \$500 per false statement.

All statutory maximum amounts on fixed dollar penalties would be eliminated. In addition, the present penalty for failure to pay taxes would be eliminated and replaced with a cost of collection charge.

Effective Date

The proposals would apply to taxable years beginning on or after January 1, 1986.

Analysis

The proposed restructuring of the penalty provisions should promote simplification in the administration of the penalty provisions and provide greater fairness in their application. The proposal would integrate many of the information reporting penalties into a single provision and provide uniform penalty amounts for similar reporting violations. Simplification of the penalty system also should promote compliance with the tax laws by enabling taxpayers to understand more easily the consequences of noncompliance.

The proposal imposes fixed dollar penalty levels for each category of information return violation. A higher penalty, based on the percentage of the unreported transaction, is imposed if the violation is willful rather than merely inadvertent or careless. Willful violations would involve deliberate, knowing or intentional disregard of filing or reporting obligations. If the heavier penalty is applicable for a willful violation, the notice and deficiency procedures generally applicable to ad valorem penalties would not apply.

The elimination of maximum penalty amounts would serve the interests of fairness and compliance. Maximum penalty amounts do not encourage compliance with the tax laws, nor do they promote uniformity of treatment among equals. There is no reason, for example, why an employer who fails to file 5,000 W-2 reports should receive relatively more favorable treatment than the employer who fails to file 50 or 500 such reports. Yet that is the result under current law, which imposes a statutory maximum on the penalty level of the larger employer.